

Rapporteur Summary Session V: Towards Global Integration of India's Financial Sector

- India's financial system has been deregulated and exposed to international financial markets along with the introduction of new instruments and products in the last 15 years
- India's financial depth i.e. financial assets (equity, government and corporate debt, bank deposits and currency) as a percentage of GDP is lower than other Asian economies
- None of the domestic market participants in the Indian financial sector are as yet of global scale
- The Indian public sector banks while enjoying dominant market share do not have the capital to make an impact on a global basis
- All recognized financial markets are moving towards greater integration and all that remains to be determined is the pace, direction and tuning of this process
- Only two-thirds of private savings are mobilized by the financial sector
- A gradualist approach to "Fuller Capital Account Convertibility" is in order
- There is need for further deregulation of interest rates
- Efficiency in the banking sector lags international competitors in terms of intermediation costs
- As the financial sector moves towards greater integration with international financial markets, interim solutions have to be found to enhance efficiency e.g. easing of barriers to entry for domestically owned new private banks, insurance and pension companies
- The collapse of equity, property and currency markets in South Asia was a direct consequence of lack of discipline
- An important conditionality to improving financial sector market efficiency is making the pricing of the Indian rupee as market determined as possible
- The Indian banking sector has advanced on many fronts since RBI began deregulation in 1991. On average non performing loans have declined to 5% of loan assets with most banks compliant with Basel 1 capital adequacy norms

- However banking system remains focused on urban areas and is heavily public sector oriented with over 73% of loan assets held by PSU banks.
- In 2005 about 40% of commercial credit went to PSUs. Productivity of investments should be given greater weightage in allocation of credit
- The over the counter (OTC) interest rate and currency swap markets cannot grow without better market determination of domestic interest rates and further capital account convertibility
- The corporate debt is miniscule and needs a series of reforms
- Exchange traded interest rate derivatives should be encouraged since this will improve market determination of domestic interest rates
- Commodity derivatives markets should be regulated by SEBI
- The Indian insurance industry is small in depth and coverage and there is tremendous potential for growth. Premiums should be deregulated and requirement to hold at least 50% of assets in government securities should be relaxed
- The pension sector is almost entirely in the public sector and covers only about 16% of the work force. The pension sector needs to be comprehensively reviewed in the light of the potential for it to help boost the equity and bond markets
- Global financial conditions are favorable for India, characterized by low risk premiums along with the resurgence of flows to emerging markets after the East Asian meltdown in 1997.
- These positive international conditions along with strong growth has made India an increasingly attractive destination for capital-resulting in more than \$5 billion in foreign direct investment, \$10 billion in foreign institutional investment and \$6 billion in private equity flows in 2005-06.
- India's high foreign exchange reserves, stable real exchange rate and low inflationary pressures insulate its financial sector from external shocks
- Indian financial sector needs to address scale and quality